



CITY OF LODI COUNCIL COMMUNICATION

AGENDA TITLE: Receive White Slough Water Pollution Control Facility Capital Improvement Project Update and Authorize the City Manager to Effectuate the Financing Plan for the Project

MEETING DATE: September 5, 2007

PREPARED BY: Public Works Director/Deputy City Manager

RECOMMENDED ACTION: Receive White Slough Water Pollution Control Facility Capital Improvement Project Update and authorize the City Manager to effectuate the financing plan for the project by the following actions:

1) Adopt resolution authorizing Stone & Youngberg to serve as Senior Managing Underwriter and Bear Stearns as Co-Manager, directing the City Manager to execute contracts on the City's behalf (payable from proceeds in an approximate amount of \$100,000 excluding "takedown" fee); 2) Authorize the City Manager to engage Lamont Financial Services for a not-to-exceed amount of \$50,000 to provide financial advisor services; and 3) Authorize the City Manager to engage Orrick, Herrington & Sutcliffe, LLP to serve as Bond Counsel (payable from proceeds in an approximate amount of \$110,000).

BACKGROUND INFORMATION: The City has made substantial progress on the State-mandated improvements at the White Slough Water Pollution Control Facility. Phase 1 – Interim Aeration Improvements and miscellaneous electrical and earthwork improvements was completed in 2003.

Phase 2 – Year 2004 Improvements Project, which was completed in 2006, included the installation of tertiary filters, UV disinfection equipment, additional aeration improvements, emergency generator, and associated electrical and mechanical facilities.

The Phase 3 project, which is underway, includes the construction of an additional secondary clarifier, an additional digester, aeration basins, headworks modifications, minor administration building modifications, and associated electrical, mechanical, utility, site preparation and demolition work. The improvements to the secondary process are necessary to meet current and anticipated State of California regulatory requirements and improve treatment process reliability. This project is being built by Western Water Constructors and is progressing well.

One element of the project consists of capital maintenance work on the headworks, which is the entry-point into the treatment plant. Performing this work requires switching flow from the domestic system to the industrial side of the facility, which involves significant temporary diverting and pumping facilities. Staff has worked with Western Water to design a permanent facility (without pumps) that will save money in the long run. (More on this in the Planned Projects discussion below.)

The total project estimate for Phase 3 is \$20,600,000 which includes: prepurchased equipment, construction administration services, environmental survey, construction contract, testing and inspection contract, construction contingencies, and other project-associated expenses.

APPROVED: _____
Blair King, City Manager

This project will bring the Facility's treatment capacity back to 8.5 million gallons per day, which has been the basis for the City's planning and financial studies for many years. This capacity should last the City another 15 to 20 years, depending on growth rates (2% to 1.5% respectively). Note that growth in wastewater generation does not necessarily track population growth. Improved water conservation measures in new construction will reduce demands on the treatment facility. However, this capacity is dependent on regulatory standards. For example, the new Air District regulations on volatile organic compounds will lead to changes in the way the City land-applies biosolids. Since we already have a very low-cost method of land application (biosolids are added to the irrigation water), and changing to either land spreading/disking or landfill disposal will require construction of de-watering facilities.

Discharge Permit

The Central Valley Regional Water Quality Control Board has issued for public comment, a Tentative Permit for Lodi's Facility. The comment period ended August 17, 2007, and Lodi, as well as others, commented on the permit. Lodi's comments focused on technical matters and compliance schedules. In brief, our comments were:

- The limits for mercury should be revised upward. The proposed permit drastically reduces the mercury limit from the previous permit. While staff believes a reduction is warranted, the levels proposed by the Board, in effect, penalize the City for the performance of the new tertiary facilities.
- The limits for ammonia should be revised. We believe there is a technical oversight in the calculation of the monthly average limit and it should be increased from 1.1 to 2.5 mg/L.
- The compliance time for the new ammonia, nitrate and nitrite limits should be extended from the proposed May 17, 2010 date to the end of the permit term. The proposed limits are stricter than anticipated in the design of the current improvement project, thus the City may need more time to plan and implement measures to meet the new limits. For example, the design anticipated a "floating limit" similar to other recent permits with an ammonia limit ranging from 2.5 to 6.1 mg/L.
- The loading limit for field application should be revised. The tentative permit contains a new limit on Biochemical Oxygen Demand (BOD) to the agricultural fields. The limit is designed to maintain aerobic conditions in the upper soil profile. While we do not dispute the concept, we had a number of technical comments on how to compute the loading and the time necessary for compliance.
- In addition, the City had a number of relatively minor technical/editorial comments on the permit.

Comments from other agencies, organizations and individuals were fairly extensive and questioned a wide range of issues. Many included references to a report issued by an engineer with the State Water Resources Control Board. This report was the topic of local newspaper articles on August 18, 2007. City staff became aware of this report on Friday, August 17 when we were contacted by the press. Having reviewed the report, staff is preparing detailed responses for the record with the Regional Board. In general, we believe:

- The report excluded pertinent information from reports issued in 2004 and 2006 and regular monitoring data.
- The report is replete with inaccurate technical statements.
- The report contains many unsubstantiated conclusions and opinions that are presented as facts.
- The report contains inaccurate legal statements not supported by current State law and policy.

The Regional Board has not yet released their responses to the comments, although staff believes there will likely be additional changes to the tentative permit. The Board intends to conduct a public hearing on the permit on September 13/14, 2007, at its regular meeting to be held in Fresno. (Note that the City's cover letter transmitting our comments requested the hearing be held in Sacramento.)

Planned Projects

Staff has prepared a five-year capital program for the White Slough Facility. This program will be used in the financial analysis (discussed later). In addition, we will have increased operating costs as both flow and regulatory requirements increase.

<u>Issue/Project</u>	<u>Estimated Cost</u>	<u>Comments</u>
Trunk Sewer Rehabilitation	\$7.5 million	Although the Phase 3 project includes some minor repairs on the pipeline between Lodi and the Facility, the entire length of the line is in need of rehabilitation in the next year. This project will require flow diversion. As part of the Phase 3 project, a permanent diversion structure is being built at the western edge of the City.
Regulatory Compliance Studies	\$365,000 per year over 5 years (avg.)	The new discharge permit requires a number of reports, studies and plans: <ul style="list-style-type: none"> • Toxicity Reduction Evaluation • Site Specific Temperature Study • Constituents of Concern/Pollution Prevention Plan • Flow Increase Report • Industrial Influent Characterization Study • Background Groundwater Quality Study • Title 22 Engineering Report • Effluent Receiving Water Characterization Study • Pollution Prevention Plan for Mg, Al, THM's • Salinity Evaluation and Minimization Plan • Report of Waste Discharge (for next permit)
Storage Ponds	\$1.5 to \$3 million	Additional storage for effluent is needed to provide operational flexibility to manage plant upsets and irrigation demands. Additional storage will certainly be needed if a recycled water distribution system is implemented. Studies on these needs are underway.
Biosolids/Effluent Land Application Management	Approx. \$5 to \$8 million	Staff and our wastewater consultants are studying various ways to meet current and anticipated regulatory requirements pertaining to land application at White Slough. A recommendation has not yet been made. The cost estimate shown assumes drying and removal of biosolids.

Need for Financing

The capital improvements are of a type and nature that have a useful life expectancy of approximately 30 to 50 years. Improvements that have a useful life expectancy of this length of time are typically financed with long term debt that is repaid over a similar time period as the useful life expectancy of the asset. Thus, there is a matching of the utilization of the capital improvement over its useful life with the burden of funding/financing it over its useful life. In addition to the financing needed for the phase 3 plant improvements, there is an opportunity to refinance at a lower interest rate, debt that was issued (1991) for capital improvements at the White Slough plant. The remaining balance of the 1991 debt is approximately \$8.6 million. Preliminary estimates show a need for issuing Certificates of Participation (COP) of approximately \$30 million to pay for the phase 3 improvements, to refinance the remaining balance of the 1991 COP and to pay for the cost of issuing the COP (underwriting, bond counsel, financial advisor, rating agency reviews, surety costs and other related issuance costs). It is necessary to procure the services of financial and legal experts to complete the financing of the project. Each of the professional engagements is discussed below starting with the Investment Banker /Underwriter.

Investment Banker/Underwriter

Two options that are typically used to sell the COP are: 1) a competitive bid process at the point of sale, or 2) a negotiated sale through an Investment Bank/ Underwriter. Although the size of this debt issue is significant to the City of Lodi, it is likely that it will not be viewed as such in the debt/investment market place. With the objective to sell the COP at the lowest net interest cost and consequently to keep the end cost to the utility customer as low as possible, the second option is recommended. Although competition typically results in the lowest interest cost, debt issues that are less than \$50 million are not considered large enough to attract more than one or two bids in a competitive sale. Under option two, the cost of the underwriting bank is thereby fixed before the sale occurs versus waiting to determine the cost of underwriting and the resultant net interest cost until bids during a competitive sale. Due to the relatively small amount of this sale, staff (in conjunction with the advice of our financial advisor Lamont Financial Services), is recommending two Underwriting Banks be engaged for this financing. Seven underwriting firms were contacted and based on a review of their qualifications, which included fee for services, familiarity with the City of Lodi, ability to market the COP to buyers and other related factors, two firms (Stone & Youngberg and Bear Stearns) were invited for interviews. The following table lists the results of the initial evaluation:

Underwriting Bank	Score
Stone & Youngberg	94
Bear Stearns	85
UBS	77
Bank of America	74
E.J. De La Rosa & Company	67
First Southwest	64
Woff, Hansen & Company	Not responsive to RFQ
Henderson Capital	No response

The interviews were conducted by the City Manager, Public Works Director, Deputy City Manager, Budget Manager, a representative from Lamont Financial Services and two members of the Budget/Finance Committee. The interviews were completed on August 28, 2007 and the recommendation from the interview team is to engage Stone & Youngberg as the Senior Manager and Bear Stearns as the Co-Manager on the financing. The fee for services will be split between the two firms and is estimated to be \$100,000 in total.

Bond Counsel

Orrick, Herrington & Sutcliff has provided services to the City of Lodi on numerous occasions related to various debt issues over the course of several years. In particular they have served as Bond Counsel for the 2004 Wastewater COP. Based on their familiarity with the covenants associated with previous Wastewater issues and their expertise in dealing with the issues associated with the City of Lodi, staff recommends utilization of them as Bond Counsel on the 2007 Wastewater COP. There fees are estimated to be \$110,000. The scope of services includes preparation of the installment sale agreement, trust agreement, escrow deposit agreement and tax certificate for the transaction, preparation of all required resolutions for the transaction, preparation of closing documents for the City and the corporation, participation in document discussions with the working group, delivery of our standard forms of approving opinion and supplemental opinion and attendance at such meetings of the City Council and corporation board as the City may request.

Financial Advisor

The City Council approved the utilization of Lamont Financial Services in February 2007. At that time Council provided direction for staff to advise them on a project by project basis as financial advisory services are needed. Lamont Financial Services has given staff an estimate of \$50,000 to provide financial advisory services on this 2007 COP project. Their scope of work is attached as Exhibit A. Lamont will provide overall financial advisory services for this project, which includes coordinating all of the necessary events through the issuance of the new COP, providing projections on the various options related to sizing and timing of the debt issue, analyzing and confirming the interest rates on the sale of securities by the Investment Banker/Underwriter, coordinating with City staff, Bond Counsel, rating agencies and the Investment Banker/Underwriter related to provision of preliminary documents and Official Statement and all other necessary documents necessary to complete the 2007 COP transaction.

FISCAL IMPACT: The rate increase adopted in 2004 assumed a three-phase project and included allowances for three COP financings and two financings have been done. Approximately \$13.3 million of proceeds from the second financing are being applied to the Phase 3 project and an additional \$1.5 million in wastewater impact fees is also available. Thus, the third financing, which will be needed to complete the project, was not done at the time the project was awarded. Staff has been working with our financial advisor on the timing and amount of the Phase 3 financing(s); taking into account the above described issues and projects, as well as potentially refinancing the older 1991 Certificates of Participation. The recommended time frame for the third financing is in the fall of 2007. We are evaluating alternative borrowing structures and phasing, as well as the possibility of State Revolving Loan fund financing for the pipeline project. Our goal will be to structure the projects and financing such that the 2004 rate increases, as well as the annual adjustments, will be sufficient for the near future.

FUNDING AVAILABLE: Funding is provided through Wastewater Rates and the COP is appropriately included in the 2007-08 budget as approved by City Council.

Richard C. Prima, Jr.
Public Works Director

James R. Krueger
Deputy City Manager

cc: Charles Swimley, Water Services Manager
Bruce West, West Yost and Associates

Del Kerlin, Wastewater Treatment Superintendent
Tom Dunphy, LaMont Financial Services

City of Lodi
Wastewater System
Refunding & New Money Issue

Time and Responsibility Revised Schedule as of August 17, 2007

Week of:	Activity	Parties
July 16	<ul style="list-style-type: none"> Preparation of Reimbursement Resolution Discussion regarding Wastewater Rate Study Consultant Preliminary Bond Sizing Numbers Circulated to Working Group Selection of Financing Team i.e. Underwriter, Bond Counsel, Verification Agent---Need to Bid for Services? 	CFO, PW, CA, BC PW FA CM, CFO, PW, CA, FA
July 23	<ul style="list-style-type: none"> Draft RFQ Circulated for Underwriting Services Revised Underwriting RFQ Circulated for Approval 	FA FA
July 30	<ul style="list-style-type: none"> Retain Rate Consultant for Bond Financing RFQ Sent to Selected Underwriters City Council Approval of Reimbursement Resolution 	PW CFO, FA CM, CFO
August 20	<ul style="list-style-type: none"> Underwriter Interviews/Recommended Underwriter to Counsel Cash Flow Analysis/Bond Sizing Requirements Refunding/New Money Bond Structure 	WG FA FA
August 27	<ul style="list-style-type: none"> Distribute 1st Draft of Plan of Finance Initial Draft of Legal Documents Circulated 	FA BC
September 3	<ul style="list-style-type: none"> Selection of Underwriter by City Counsel Bond Financing "Kick-Off" Meeting Bond Document Meeting/Review Initial Rate Study Findings Review 1st Draft of Legal Documents/Circulate 2nd Draft 	CM, CFO WG WG BC
September 10	<ul style="list-style-type: none"> Document Session to Review 2nd Legal Document Drafts Distribute 1st draft of Preliminary ratings presentation Review Final Draft of Rate Study Initial Draft of Preliminary Official Statement ("POS") Circulated Preliminary Discussions with Bond Insurers Initial Conversation with Rating Agencies 	BC WG UW PW UC UW, FA, CFO
September 17	<ul style="list-style-type: none"> Distribute 3rd draft of Legal Documents, 2nd draft of POS Structure Bond Sizing Model with Rate Study Findings Meeting/call on 2nd draft of POS, 3rd draft of Legal Documents Distribute 2nd draft of Preliminary ratings presentation 	UC, BC FA, UW WG UW, FA
September 24	<ul style="list-style-type: none"> Call/meeting to review 2nd draft of Preliminary ratings presentation Distribute 3rd draft of POS, 4th draft of Legal Documents Rehearsal call/meeting for Preliminary ratings meeting 	WG UC/BC WG
October 1	<ul style="list-style-type: none"> Preliminary Rating Agency Meetings Call to review 3rd draft of POS, 4th draft of bond documents Distribute 1st draft of Bond Purchase Agreement (BPA) Distribute 5th draft of POS 	WG UC UC UC
October 8	<ul style="list-style-type: none"> Call to release 5th draft of POS and Legal Documents to rating agencies and credit enhancers Distribute 2nd draft of BPA and 1st draft of syndicate policies 	WG UC, CFO
October 15	<ul style="list-style-type: none"> Calls with bond insurers Distribute draft internet road-show presentation and hold conference call to review same Receive credit enhancement proposals; conference call to review same Conference call to review and finalize syndicate policies Distribute 3rd draft of BPA 	UW, FA, PW, CFO UW UW, FA, CFO UW, CM, CFO, UC

City of Lodi
Wastewater System
Refunding & New Money Issue
Time & Responsibility Schedule

October 22	<ul style="list-style-type: none"> Receive rating indications; negotiate final terms Distribute revised POS and legal documents reflecting any changes for consideration by the City Council Distribute and finalize internet road show One-on-One conference calls with investors as requested Distribute financing schedule of events and calls and syndicate policies to CMs 	UW, FA WG UW UW UW, FA
October 29	<ul style="list-style-type: none"> Due diligence call with CMs City Council approve documents Post POS 	WG WG UC
November 5	<ul style="list-style-type: none"> Retail Order Period and Pricing 	UW
November 8	<ul style="list-style-type: none"> Mail Final POS 	WG
November 15	<ul style="list-style-type: none"> Closing 	WG
February 1, 2008	<ul style="list-style-type: none"> Call Series 1991 Wastewater System Revenue Bonds 	T

Legend – Interested Parties

Lodi	City of Lodi
CM	City Manager
CFO	Chief Financial Officer
CA	City Attorney
PW	Public Works
BC	Bond Counsel – Orrick Herrington & Sutcliffe
FA	Financial Advisor – Lamont Financial
UC	Underwriters' Counsel
UW	Senior Manager
WRC	Wastewater Rate Consultant
CM	Co-Managing Underwriters
WG	Working Group
VA	Verification Agent
T	Trustee

RESOLUTION NO. 2007-

A RESOLUTION OF THE LODI CITY COUNCIL
AUTHORIZING STONE & YOUNGBERG TO SERVE AS
SENIOR MANAGING UNDERWRITER AND BEAR
STEARNS AS CO-MANAGER

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WHEREAS, the City of Lodi needs to procure Investment Banking/Underwriting, services for the financing of White Slough Wastewater Treatment Plant Capital Improvements ; and

WHEREAS, the City of Lodi has reviewed and ranked the qualifications of seven Investment Banking/Underwriter firms that were requested to submit qualifications after which two of those firms (Stone & Youngberg and Bear Stearns) were interviewed; and

WHEREAS, a committee of City staff, the City's financial advisor and two members of the Budget and Finance Committee recommended that Stone & Youngberg serve as Senior Managing Underwriter and Bear Stearns as Co-Manager ; and

NOW, THEREFORE, BE IT RESOLVED that the City Council of the City of Lodi does hereby authorize the City Manager to enter into agreements to provide financial services with Stone & Youngberg and Bear Stearns.

Dated: September 5, 2007

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I hereby certify that Resolution No. 2007- was passed and adopted by the City Council of the City of Lodi in a regular meeting held September 5, 2007, by the following vote:

AYES: COUNCIL MEMBERS –

NOES: COUNCIL MEMBERS –

ABSENT: COUNCIL MEMBERS –

ABSTAIN: COUNCIL MEMBERS –

RANDI JOHL
City Clerk